

ASARCO INC.

IBLA 96-559, 96-561

Decided February 29, 2000

Appeal from decisions of the Deputy Commissioner of Indian Affairs, Bureau of Indian Affairs, requiring recalculation and payment of additional royalties (IBLA 96-559) and interest charges (IBLA 96-561) on Indian mining leases. MMS-93-0129-IND, MMS-93-0462-IND.

Affirmed.

1. Administrative Procedure: Administrative Record--
Administrative Procedure: Administrative Review

In reviewing a decision of the MMS, the Deputy Commissioner of Indian Affairs, Bureau of Indian Affairs, is required to review the entire record, including all evidence submitted by lessee in support of valuation for royalty purposes, without regard to whether it was reviewed below. Where it clearly appears that consideration of a second arm's-length contract would not alter MMS' analysis or conclusions, and appellant has not alleged or shown that a different result would be required if the second contract was considered, the failure to do so will be held to be harmless error.

2. Indians: Mineral Resources: Generally--Indians:
Mineral Resources: Oil and Gas: Royalties

Where a lessee fails to offer independent indicia establishing that its nonarm's-length, net smelter return contract price is one fairly derived from the marketplace, MMS properly establishes royalty on copper concentrates based on an arm's-length, net smelter return contract pursuant to applicable regulations.

3. Oil and Gas Leases: Royalties: Interest

The regulation at 30 C.F.R. ' 218.202(a) requires the assessment of interest on unpaid and underpaid amounts from the date the amounts are due. Late

payment charges ensure that Federal and Indian lessors do not lose the time value of money due and owing in situations where royalties were initially underpaid and then later corrected.

APPEARANCES: Burton M. Apker, Esq., and Gerrie Apker Kurtz, Esq., Phoenix, Arizona, for Appellant; Peter J. Schaumburg, Esq., Howard W. Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE PRICE

ASARCO, Inc. (ASARCO), has appealed an April 1, 1996, decision of the Deputy Commissioner of Indian Affairs, Bureau of Indian Affairs (BIA), docketed as IBLA 96-559, and a May 28, 1996, decision of the Acting Deputy Commissioner of Indian Affairs, BIA, docketed as IBLA 96-561. The April 1, 1996, decision upheld a March 3, 1993, Minerals Management Service (MMS) demand letter requiring ASARCO to conduct a restructured accounting for the period between September 1, 1984, and December 31, 1986, and to pay additional royalty on Indian Mining Lease Nos. M15-454260-0 and M15-454360-0. ASARCO complied with MMS' order and, under protest, paid additional royalties of \$95,504.83.

Thereafter, in the May 28, 1996, decision in IBLA 96-561, the Acting Deputy Commissioner of Indian Affairs upheld a July 27, 1993, letter decision requiring ASARCO to pay late payment charges totaling \$35,864.15 on the additional royalty assessed in IBLA 96-559. Because ASARCO's appeal in IBLA 96-561 is derived from its challenge to the underlying assessment of additional royalties appealed in IBLA 96-559, 1/ we consolidate the two appeals, but our discussion will focus on the merits of the appeal in IBLA 96-559.

These appeals involve mining operations conducted by the Southwestern Mining Department of ASARCO on two Papago Indian Tribe 2/ leases, M15-454260-0 and M15-454360-0, which are situated in southern Arizona on approximately 2,550 acres of the San Xavier Indian Reservation and form part of the Mission Unit Mining Complex operated by ASARCO. (Decision at 1; SOR at 2.) The original leases were approved by the BIA, U.S. Department of the Interior, in 1959. The principal metal in the ore extracted from the leases is copper. (SOR at 2.) There is no dispute as to the applicable terms of the royalty provisions of the leases. 3/ As

1/ MMS sought to dismiss ASARCO's appeal in IBLA 96-559 for failure to file an adequate statement of reasons (SOR). We denied that motion on Oct. 30, 1996.

2/ ASARCO states that Papago Indian Tribe is now known as the Tohono O'odham Nation. (SOR at 2 n.4.)

3/ The royalty section of the leases provides as follows.

"4. In consideration of the foregoing, the lessee agrees: (a) ROYALTY - To pay, or cause to be paid, to the Superintendent, Papago Agency, for the use and benefit of the Indian landowners, a royalty as follows: (1) Ten percent of the value at the shipping point for substances other than gold, silver, copper, lead, zinc, tungsten, coal, asphaltum,

noted above, however, the Deputy Commissioner concluded that these terms did not fairly reflect the fair market value of copper concentrates for the purpose of determining the basis upon which royalty would be assessed.

The applicable regulation 4/ provided:

(a) The gross value for royalty purposes shall be the sale or contract unit price times the number of units sold, Provided, however, That where the authorized officer determines:

(1) That a contract of sale or other business arrangement between the lessee and a purchaser of some or all of the commodities produced from the

fn. 3 (continued)

and uranium and allied substances; * * * (3) Ten percent of the value of the ores or concentrates for copper, lead, zinc, and tungsten as shown by reduction returns after deducting the freight charge to the point of sale. All royalty accruing for any month shall be due and payable before the twenty-fifth day of the following month. During the period that any of the lease is under Federal jurisdiction, the royalty provisions of this lease shall be subject to reasonable adjustment by the Secretary of Interior or his authorized representative at the end of the first and each successive 10-year period, such adjustment being based upon market conditions as supported by evidence from the field."

Subsection (3) of the royalty section later was modified by the terms of a Nov. 3, 1971, agreement settling a class action lawsuit filed by the Papago Indian Tribe against ASARCO in U.S. District Court in Arizona, CIV. 70-83 TUC. A copy of the agreement appears in the record as Attachment 11 to the July 19, 1993, memorandum from the Area Manager of the Tulsa Area Audit Office of MMS to the Appeals Division of MMS (Field Report). Section IV of the settlement agreement provided that royalties would be paid on the value of copper concentrates, calculated on the basis of net smelter returns.

4/ The Deputy Commissioner relied upon 30 C.F.R. ' 231.61, which she identified as having been redesignated as 30 C.F.R. ' 206.301, as the applicable regulation. ASARCO, on the other hand, argued that the applicable regulation was 43 C.F.R. ' 3597.2 (1986). In point of fact, however, these are the same regulations. The initial regulation, 30 C.F.R. ' 231.61 was redesignated as 43 C.F.R. ' 3577.2 on Aug. 12, 1983, 48 Fed. Reg. 36588. Later that year, the regulation was modified by substituting the term "authorized officer" for "Mining Supervisor." 48 Fed. Reg. 44795 (Sept. 30, 1983). Two and one-half years later, 43 C.F.R. ' 3577.2 was redesignated as 43 C.F.R. ' 3597.2, 51 Fed. Reg. 15213 (Apr. 22, 1986). A little more than 2 years later, 43 C.F.R. ' 3597.2 was redesignated as 30 C.F.R. ' 206.31. While the subject regulation has existed under a variety of designations, the substance has been constant since its original promulgation.

lease is not a bona fide transaction between independent parties because it is based in whole or in part upon considerations other than the value of the commodities, or (2) That no bona fide sales price is received for some or all of such commodities because the lessee is consuming them, the authorized officer shall determine their gross value, taking into account: (i) All prices received by the lessee in all bona fide transactions, (ii) Prices paid for commodities of like quality produced from the same general area, and (iii) Such other relevant factors as the authorized officer may deem appropriate.

With respect to calculating royalties on the basis of a net smelter return, the Deputy Commissioner stated: "In accordance with industry usage, the net smelter return is calculated by deducting certain smelting, refining and transportation costs from a referenced published or index price for the refined metal. See 3 American Law of Mining, Sec. 85.03, Rocky Mountain Mineral Law Foundation 2nd Ed. (1988)." (Decision at 2.) The parties are in substantial agreement on this point. (SOR at 3, 4.) The dispute arises from the manner in which MMS determined the value of the concentrates for royalty purposes. MMS concluded that from September 1984 through December 1986, ASARCO valued copper concentrates produced from the leases using a net smelter return which was based upon a nonarm's-length contract between ASARCO and its Southwestern Mining Department (Southwestern), Agreement No. C84005 (the ASARCO contract). Accordingly, to determine whether the copper concentrate values under the nonarm's-length contract were acceptable, MMS requested ASARCO to provide additional support for the valuation. In response, ASARCO provided a contemporaneous arm's-length contract between ASARCO and Kennecott Sales Company (Kennecott) for ASARCO's purchase of concentrates produced from Kennecott's Ray Mines (the Kennecott contract).

Comparing the two agreements, the Deputy Commissioner stated:

The record shows that the ASARCO contract and the Kennecott contract both involve the sale of copper concentrates and each prescribes per ton payments for silver and copper and per ton deductions for treatment and refining. The copper payments and the treatment charges are exactly the same but the silver payment was slightly higher under the Kennecott contract. The refining charges deductible under the ASARCO contract are nearly twice those prescribed by the arm's-length, Kennecott contract. Because the refining deductions under the non-arm's-length ASARCO contract were higher, the net smelter returns were consistently less than those earned under the arm's-length Kennecott contract. The [MMS] comparison for the period September 1984 through December 1986 showed a weighted average net smelter return under the arm's-length Kennecott

contract of \$292.27 per ton and a weighted average net smelter return under the non-arm's-length ASARCO contract of \$243.91 per ton.

(Decision at 2-3.)

The Deputy Commissioner recited that MMS therefore had concluded that the two contracts were not comparable for royalty purposes because of the large discrepancy in the deductible refining charges used in calculating the net smelter returns, finding that ASARCO should have used the Kennecott contract prices as the value basis for the copper concentrates. (Decision at 3.) MMS thus rejected ASARCO's contention that its contract price was equivalent to an arm's-length contract and accurately reflected prevailing market values, and also rejected ASARCO's argument that MMS had taken certain price terms out of context and disregarded others necessary to establish the price Southwestern paid for concentrates under each agreement. (Decision at 5.)

More specifically, ASARCO had contended:

The bottom-line price for concentrates under each contract is the point that matters. Each contract has a variety of terms that work [sic] in concert to provide the bottom line price. That price is the amount paid for concentrates, i.e. the value of the concentrate the mines deliver to the smelter under the contract. Any comparison of smelter contracts that focuses on some, but not all, of the terms of the contracts will result in an inaccurate analysis. Only a comparison of the bottom line price has validity.

(Decision at 5 citing ASARCO's December 4, 1992, letter from T.E. Scartaccini to Gary L. Johnson, Area Manager, Dallas Area Compliance Office, MMS.)

In response, the Deputy Commissioner acknowledged that the copper concentrate price is the most significant factor for comparison in judging the comparability of net smelter return contracts. She observed, however, that it is also necessary to review the comparability of all the factors comprising the net smelter return in nonarm's-length agreements, because the net smelter return could be manipulated by inflating or deflating the component factors. Absent such analysis, she noted, there can be no assurance that the deductible costs actually portray the true market value of the services provided. (Decision at 5.)

As further support, the Deputy Commissioner relied upon MMS' July 19, 1993, Field Report, stating:

Normally, in an arm's-length concentrate purchase arrangement, the refining charge is negotiated within the borders of a competitive marketplace, which involves consideration given to

the relative scarcity or abundance of concentrates and the prevailing prices of refined metals, as well as the operating and investment costs of the smelter. One of the commonly used terms of these competitive type factors is a refining charge "escalator" referred to as "price participation," whereunder the refining charge is increased under some agreed-upon formula when copper prices are above some benchmark price. In an integrated mining and smelting operation under control of a single company, a refining charge may be determined through review of that smelter's actual costs. However, since the Appellant has asserted that its non-arm's-length Agreement No. C84005 is comparable to its arm's-length Agreement No. C83031, the review was made not of the smelter's actual cost but rather of the comparability of the non-arm's-length refining charge versus the refining charge in the arm's-length concentrate purchase agreement.

(Decision at 6, citing the Field Report at 6.) Consequently, the Deputy Commissioner found that MMS had correctly determined that the concentrate values properly should be based on the values calculated under the arm's-length Kennecott contract, Agreement No. C83031.

On appeal to this Board, ASARCO presents three principal arguments: (1) that the integrated nature of ASARCO and Southwestern is an inadequate basis for rejecting the price terms of the ASARCO contract for royalty purposes; (2) that MMS has erroneously determined royalties by reference to one particular smelter agreement even though not all of the mine's production was sold pursuant to that particular smelter agreement; and (3) that MMS' net smelter return analysis was incorrect because it took certain price terms out of context while disregarding other terms, the effect of which was to ignore the bottom-line price paid. (SOR at 2.)

Citing Exhibit H to its SOR, among others, ASARCO asserts that it has repeatedly offered to meet with MMS and to provide such additional information as MMS might require. (SOR at 7.) Exhibit H is the December 4, 1992, letter from ASARCO to the MMS Dallas Area Compliance Office which was included in MMS' Field Report as Attachment 11. It includes Schedules A and A-1, which compare relevant terms of the ASARCO and Kennecott contracts. In that letter, ASARCO argued the significance of its schedules as follows:

Enclosed are Schedules A and A-1 which properly compare the Ray (C83031) and Asarco (C84005) contracts and employ the actual prices of copper and silver. These schedules demonstrate that the two principal differences between the two contracts were terms for payable silver and terms for refining and delivery.

These schedules utilize pricing for September 1984 and March 1986, production as per your sample months. This

comparison shows that the bottom-line values are comparable, and in fact slightly in favor of the ASARCO contract.

(Ex. H at 2.) With that letter, however, ASARCO provided another arm's-length contract for MMS' consideration, an agreement with Phelps Dodge Corporation. The letter failed to reference the agreement by its number, but it appears to be Agreement No. C87001, revised May 6, 1987, a copy of which is included in the record.

With respect to the first contention, Appellant argues that

MMS' discretion to ignore contracts for the sale of mine production and independently determine value for royalty purposes is expressly limited. * * * MMS could disregard the smelter agreements pursuant to which production under the mining leases was sold only upon determining that those agreements were (1) not between independent parties, and (2) were based "upon considerations other than value" of the mine production, and (3) were not executed in good faith.

(SOR at 10-11, citing 43 C.F.R. ' 3576.2 (1984)). Citing Getty Oil Co., 51 IBLA 47, 51 (1980), ASARCO challenges the legal sufficiency of MMS' finding that the ASARCO contract was not a bona fide transaction (Decision at 5), on the ground that there was no evidence or any finding that Agreement No. C84005 was based on considerations other than the value of the mine output.

(SOR at 11, 12.) Appellant's further arguments (SOR at 11-13) suggest that ASARCO interprets the provisions of 43 C.F.R. ' 3577.2 (1984) as requiring affirmative evidence that the parties acted in bad faith in forming the contract and a determination that the contract is invalid as a matter of law before MMS may require recourse to other methods of valuation. If that is ASARCO's position, it is an unduly expansive construction of the regulation.

ASARCO is correct in its assertion that a parent and a subsidiary can enter into a bona fide contract, and that the parties' affiliation does not, standing alone, justify disregarding their smelter agreement. (SOR at 13.) The test is whether the contract establishes a price an unaffiliated party in the marketplace would pay for a commodity of like quality and quantity at the point in time being scrutinized:

Although contracts between a parent corporation and its subsidiary may not be at arm's length, they may result in a fair market price. If a transaction is not at arm's length, some other manifestation that the price is nonetheless an accurate portrayal of the article's worth is required. It must be a price which independent buyers in arm's length transactions would be willing to pay. Acme Manufacturing Co., Inc. v. United States, 492 F.2d 515, 520 (5th Cir. 1974).

Getty Oil Co., supra at 51.

In this case, there is no question that ASARCO and Southwestern are affiliates. Whether the price provided by the ASARCO contract reflects

the fair market price for copper concentrates of similar quality during the period in question is an objective question, the answer to which is established by the highest prices ASARCO actually would pay or receive pursuant to contracts with unaffiliated entities. 5/ Transco Exploration Co. & TXP Operating Co. (Transco), 110 IBLA 282, 286, n.2 (1989); Amax Lead Company of Missouri (Amax Lead), 84 IBLA 102, 111 (1987). Contrary to ASARCO's contentions, it is not necessary to show that Appellant's and Southwestern's execution of the ASARCO contract was accomplished in a deceitful, fraudulent, or dishonest manner. Instead, the inquiry is whether the contract is one to which parties with adverse economic interests would agree. Amax Lead, *supra* at 111; Getty Oil Co., *supra* at 51. Where, pursuant to an arm's-length contract for a like product during the relevant period, an independent buyer in the marketplace paid a higher price than that paid by lessee's affiliate, it is entirely proper to conclude that the affiliate's price was based on considerations other than value. See Transco, *supra* at 338-42.

Appellant's second argument is that it was error to calculate royalties on the basis of the Kennecott smelter contract because not all of the mine production was sold pursuant to that contract. However, ASARCO offers no explanation of why or how the question of whether all or a part of mine production was sold pursuant to the Kennecott agreement is material to valuation for royalty purposes. The applicable regulation, 43 C.F.R. ' 3577.2(a)(1) (1984), specifically refers to contracts or arrangements for the sale of "some or all of the commodities produced from the lease," and as discussed above, the relevant inquiry is whether the Kennecott agreement reflects the highest price ASARCO actually paid for concentrates of substantially similar quality. It is not enough to show that the agency's method is or may be susceptible to error; an appellant challenging a valuation must also show that error in fact occurred. Exxon Corp., 118 IBLA 221, 246 (1991), citing Phillips Petroleum Co., 109 IBLA 4, 7 (1989); Davis Exploration, 112 IBLA 254, 259 (1989); Amoco Production Co., 85 IBLA 121, 129 (1985); Amoco Production Co., 78 IBLA 93, 100 (1983); Supron Energy Corp., 55 IBLA 318, 322 (1981).

[1] As noted above, ASARCO submitted two arm's-length contracts, the Kennecott and Phelps Dodge agreements. To the extent that Appellant challenges MMS' failure to consider the Phelps Dodge agreement, we agree that the decision and record do not show or suggest what weight, if any, MMS accorded to this contract in its deliberations. It is well-established that MMS was required to consider any evidence offered by ASARCO, and that Appellant was entitled to a reasoned decision that fully addressed that evidence. The Navajo Nation, 150 IBLA 83, 88 (1999); Arizona Silica Sand Co., 148 IBLA 236, 241 (1999); Pittsburg & Midway Coal Mining Co. v. OSMRE, 140 IBLA 105, 109 (1997), and cases cited therein; Predator Project,

5/ For that reason, Appellant's argument that at all relevant times the lessors were aware that production under the leases would be sold to ASARCO's smelter, and yet did not object (SOR at 12), is beside the point.

127 IBLA 50, 53 (1993), and cases cited therein. However, while ASARCO attacks MMS' valuation for relying only on the Kennecott contract, ASARCO has not explained how consideration of the Phelps Dodge contract would have altered MMS' analysis and conclusions or the outcome of the audit.

As part of our review, we assumed that MMS did not consider the Phelps Dodge contract and compared it to the other two agreements. The Kennecott and Phelps Dodge arm's-length agreements are similar in most respects, ^{6/} but what is most important is that they both provided for a refinery charge that was less than half of what was charged under the ASARCO contract. ASARCO's arguments to the contrary notwithstanding, this is an adequate basis for concluding that the ASARCO contract was not comparable to an arm's-length agreement. If there is a unique aspect to any feature of the pricing structure under the three contracts that MMS overlooked, ASARCO clearly has failed to identify or articulate it. Thus, in our view, the Phelps Dodge contract buttresses rather than weakens MMS' conclusions. Having failed to allege or show any reason why consideration of the Phelps Dodge contract would compel a different analysis or result, we find that MMS' failure to address it is harmless error.

[2] ASARCO's final argument is that MMS has relied on certain elements of price to the exclusion of others, ignoring consideration of the bottom-line prices of the ASARCO and Kennecott agreements. The fact is, however, that MMS' conclusion that the disparate refinery charge resulted in an average bottom line price that was \$48.36 less than the price paid in the marketplace for a comparable product, whether measured by the Kennecott contract or the Phelps Dodge contract, stands unrefuted. The essential fact is that ASARCO paid less royalty than it would have, had it paid a fair market refining charge.

[3] The final matter to be addressed is interest. Under the applicable regulation, 30 C.F.R. ' 218.202(a), "[t]he failure to make timely or proper payment of any monies due pursuant to leases and contracts subject to these rules will result in the collection by MMS of the full amount past due plus a late payment charge." Under 30 C.F.R. ' 218.202(b), such interest "will be assessed on any late payment or underpayment from the date that the payment is due until the date that the payment was received * * *." Bear Coal Co., Inc., 136 IBLA 59, 63 (1996); Ametex Corp., 121 IBLA 291, 293 (1991); ASARCO Inc., 128 IBLA 116, 128 (1990); Utah International, Inc., 107 IBLA 217, 221 (1989). As ASARCO underpaid royalties on its copper concentrates, it was proper to assess late payment interest. The decisions will be affirmed, thus mooted ASARCO's Motion for Oral Argument.

^{6/} We note that the Phelps Dodge contract provided for a fixed treatment price of \$66.30 per dry short ton, whereas the ASARCO and Kennecott contracts provided for a price of \$62.50 per dry short ton with a price escalator after a benchmark price was reached. Neither party has attributed any particular significance to this element.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. ' 4.1, the decisions in IBLA 96-559 and IBLA 96-561 are affirmed, and the Motion for Oral Argument is denied as moot.

T. Britt Price
Administrative Judge

I concur:

James L. Burski
Administrative Judge